IT 00-5
Tax Type: Income Tax
Issue: Statute of Limitations Application

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. 98-IT-0000** **FEIN: 13-0000000** **Tax yr.: 10/31/91**
v.	
"THE QUEEN'S BANK", Taxpayer	**Charles E. McClellan** **Administrative Law Judge**

ORDER GRANTING TAXPAYER'S MOTION FOR SUMMARY JUDGMENT

This matter comes on for consideration of a motion for summary judgment filed by the taxpayer, "The Queen's Bank", ("TQB") and a cross-motion filed by the Department of Revenue. This administrative proceeding results from the denial of a refund claim for corporate income tax filed by "TQB" for the tax year ended October 31, 1991. The Department denied the refund claim averring that the claim was barred by the statute of limitations. Although, the Department revised the receipts included in the numerator of the unitary business group's Illinois sales factor, that adjustment is not an issue. The Department agrees in its cross-motion that there is no dispute as to any material fact. The uncontroverted facts set forth in "TQB's" memorandum in support of its motion are supported by affidavit. The relevant facts are set forth below.

Facts

1. "TQB" is a banking corporation incorporated in Canada. (Taxpayer Ex. B ¶ 3[1])

2. During the period under audit, "TQB" did business in the United States through branch offices and domestic (U.S.) subsidiary corporations. (*Id.*)

3. For federal income tax purposes, "TQB" filed form 1120F reporting its business profits attributable to its U.S. permanent establishment as determined pursuant to the terms of the U.S. — Canada Income Tax Treaty. (*Id.*; Taxpayer Ex. No. 2[2])

4. "TQB Illinois Inc." ("TQB-I") and "TQB Securities USA, Inc." ("TQB- S") are both wholly owned domestic subsidiaries of "TQB Holdings U.S.A. Inc.", which in turn is a wholly owned subsidiary of "TQB". (Taxpayer Ex. B ¶ 2; Taxpayer Ex. No. 2)

5. The Department audited the Illinois income tax liabilities of "TQB" and its wholly owned subsidiaries "TQB-I" and "TQB-S" for the tax years ended October 31, 1991, 1992, and 1993. (Taxpayer Ex. B ¶ 5; Taxpayer Ex. No. 2)

6. For the period under audit and prior years, all parties agree that "TQB", "TQB-I", and "TQB-S" were engaged in a unitary business. However, for each of the periods under audit, "TQB", "TQB-I", and TQB-S" each filed separate Illinois income tax returns. (Taxpayer Exs. No. 2, 3, 6; Taxpayer Ex. B ¶ 7)

7. "TQB" filed separate Illinois returns based on the theory that it could not be included in the unitary business group, which included "TQB-I" by reason of the

[1] Exhibit B is the affidavit of "Peter S. Faversham" who is the Director U.S.A. Taxation in the Taxation Department of "The Queen's Bank"
[2] Taxpayer Ex. No. 2 is the Audit Narrative prepared by the Department's auditor, Marvin J. Lumpkin.

80/20 rule. (Taxpayer Ex. No. 3, Schedule UB, Part 1, Section C.)[3] For all relevant periods, taken on a worldwide basis, over 80 percent of "TQB's" business activity was conducted outside the U.S. (Taxpayer Ex. B ¶ 8.)

8. "TQB-I" and "TQB-S" each filed on a "separate unitary" basis for the years under audit. (Taxpayer Ex. No.3).

9. Upon audit the Department asserted that "TQB" and "TQB-I" should be treated as members of a single unitary business group as defined under Section 1501(a)(27)[4], and that they should have filed a single combined report for the years under audit. (Taxpayer Ex. B ¶ 6; Taxpayer Ex. No. 2.)

10. On or about January 17, 1996, during the course of the audit, "TQB-I" executed a Consent to Extend, tolling the statute of limitations for the 1991 and 1992 tax years for itself and "TQB-S" until and including January 31, 1997. (Taxpayer Ex. No. 4.)

11. In December of 1996, prior to the expiration of the statute of limitations as extended by the Consent To Extend signed by "TQB-I", "TQB" and "TQB-I" both filed refund claims in the form of amended returns to recover their respective overpayments for the 1991, 1992, and 1993 tax years. No amended returns were filed on behalf of "TQB-S" as it had no Illinois income tax liability during the period at issue. (Taxpayer Ex. B ¶ 11; Taxpayer Exs. No. 2, 5, 7)

12. The amended returns filed by "TQB" brought all its items to zero, and transferred all its activity, payments, and tax liability, to the amended return filed by "TQB-I".

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[3] The taxpayer based this conclusion on Section 1501(a)(27) of the Illinois Income Tax Act, 35 ILCS 5/1501(a)(27), which provides that companies with 80 percent or more foreign business activity cannot be included in the same combined report as entities with primarily domestic business operations.

[4] Unless otherwise noted, all statutory references are to 35 ILCS 5/101, *et seq.*, the Illinois Income Tax Act ("IITA").

These returns closed or zeroed out the separate returns filed by “TQB” and shifted all activity of “TQB” to combined returns filed by “TQB-I”, thereby effectively creating a combined unitary return including “TQB” and “TQB-I”. (Taxpayer Ex. B ¶ 11; Taxpayer Exs. No. 2, 5, 7.)

13. The amended returns were initially accepted by the auditor and determined to accurately incorporate the recommended audit adjustments. (Taxpayer Ex. No. 2.)

14. Later, in a letter dated June 30, 1997 from Marvin J. Lumpkin (the Department’s auditor) to “Jane Doe” (a “TQB” employee), the Department stated that because “TQB” and “TQB-I” did not originally file on a combined unitary basis, they were precluded from amending their tax returns on that basis, and the Department required “TQB” and “TQB-I” to file separate unitary returns for the tax years ended October 31, 1991, 1992, and 1993. (Taxpayer Ex. No. 6.)

15. The auditor accepted the revised refund claims filed by both entities for tax years ended October 31, 1992 and 1993 as well as the October 31, 1991 refund claim filed by “TQB-I”, but denied the refund claimed by “TQB” for the tax year ended October 3l, 1991. (Taxpayer Ex. No. 2,)

Issue

The issue is whether “TQB’s” refund claim for the tax year ended October 31, 1991 was untimely. (Taxpayer Ex. No. 2) The Department asserts that the three year statute of limitations, pursuant to Section 911(a) of the Illinois Income Tax Act, 35 ILCS 5/911(a), had expired for “TQB”, even though “TQB-I” had extended the statute for the rest of the unitary business group, which the auditor determined included “TQB”.

Taxpayer argues that the extension of the three year statute of limitations by "TQB-I" extended the statute for the entire unitary business group including "TQB" because Illinois law permits the correction of a failure to include a member in a combined tax return.

Conclusions of Law

Summary Judgment is a drastic means of disposing of litigation and therefore should be allowed only when the right of the moving party is clear and free from doubt. Purtill v. Hess, 111 Ill.2d 229, 489 N.E.2d 867 (1986). In determining the existence of a genuine issue of material fact courts must consider the pleadings, depositions, admissions, exhibits, and affidavits on file and they must be strictly construed against the movant and in favor of the non-movant. *Id.* If the movant supplies facts which, if not contradicted, would entitle the movant to judgment as a matter of law, the opposing party cannot rely on his pleadings alone to raise issues of material fact. *Id.* Therefore, facts contained in an affidavit in support of a motion for summary judgment which are not contradicted by counter-affidavit are admitted and must be taken as true for purposes of the summary judgment motion. *Id.* The sufficiency of an affidavit in support of or in opposition to a motion for summary judgment is governed by Supreme Court Rule 191. Among other things, the rule requires that sworn or certified copies of all papers upon which the affiant is relying be attached to the affidavit. *Id.* In the case at issue, the taxpayer's motion is supported by affidavit and other documents and the Department agrees that there is no genuine issue as to a material fact.

In analyzing the situation presented by the taxpayer's motion for summary judgment, it is helpful to review the most significant relevant facts. For the tax years ended October 31, 1991, 1992, and 1993, “TQB”, “TQB-I” and “TQB-S” were members of a unitary group. “TQB-S” had no taxable presence in Illinois although it was a member of the “TQB” unitary group. Because “TQB-S” had no presence in Illinois, the Department’s regulation, 86 Ill. Admin. Code § 100.5201(i), barred “TQB-S” from being included in a combined return with “TQB” even though it was a member of the unitary group. “TQB-I” and “TQB-S” filed separate unitary Illinois returns for the years at issue.

For these years, “TQB” filed separate Illinois income tax returns because it believed that it could not file on a combined basis with “TQB-I” because of the so-called “80/20 rule” set forth in Section 1501(a)(27). This rule provides that a unitary group of corporations for purposes of filing a combined return cannot include a member whose business activity outside the United States is 80% or more of the member’s total business activity. “TQB”, being a Canadian company with more than 80% of its business outside the United States, concluded that under the 80/20 rule it could not enter into a combined return with “TQB-I”.

On or about January 17, 1996, during the course of an audit of its Illinois income tax returns, “TQB-I” executed a consent to extend the statute of limitations for the tax years 1991 and 1992 for itself and “TQB-S”. The consent extended the expiration of the statute of limitations until January 31, 1997. During the course of the audit, the Department’s auditor determined that “TQB” and “TQB-I” are members of a unitary group of corporations as defined in Section 1501(a)(27). The Department also determined that they should have filed single combined returns for the years 1991, 1992, and 1993, the years under audit.

The Department based its determination on its interpretation of the 80/20 rule, which differed from the taxpayer's interpretation. The 80/20 rule, Section 1501(a)(27), states that if more than 80% of a company's business activity occurs outside the United States, it cannot be included in a combined return. In the case of a non-U.S. corporation that does business in the United States through branches and subsidiary corporations, the Department does not apply the 80/20 rule on worldwide basis as the taxpayer did in this case. In such a case the Department only considers the U.S. business activity of the foreign corporation. Under the Department's interpretation, more than 80% of "TQB's" business activity was in the U.S., so it could have been included in a combined return.

The Department's position is not addressed in the regulation dealing with unitary business groups, Reg. § 100.9700, or in any other regulation and it caused a degree of confusion and misunderstanding. To demonstrate the confusion, taxpayer quotes text from question 5 of the 1998 Practitioners' Liaison Group Meeting with the Department on October 29, 1998. That text is as follows:

> Nothing in the 80/20 statutory test language suggests that the General Assembly intended to include in a combined unitary return the effectively connected income of a foreign corporation which has less than 20% of its payroll and property in the United States while excluding the income of a domestic company with exactly the same amount of its property and payroll in the United States. In fact, the most logical inference from the statute is that the foreign company's income would be excluded.

To correct the situation resulting from the Department's interpretation of the 80/20 rule, in December of 1996 "TQB" and "TQB-I" filed refund claims in the form of amended returns for 1991, 1992, and 1993 to reflect the Department's determination and to recover their respective resulting overpayments. The amended return filed by "TQB" reflecting the Department's determination brought all of its income and expense items to zero and transferred them to the amended return filed by “TQB-I” thus making it a combined return for “TQB-I” and “TQB”.

These amended returns were filed during the period that the statute of limitations was tolled because of the consent to extend it which “TQB-I” signed and before a Notice of Deficiency was issued. The Department argues, however, that for the year ended October 31, 1991, the statute of limitations barred the refund claim filed by “TQB” because the consent to extend the statute executed by “TQB-I” only included “TQB-I” and “TQB-S”.

A determination of the issue involved in this case must begin with Section 502(e) which, in relevant part, provides as follows:

> For taxable years ending on or after December 31, 1985, and before December 31,1993, taxpayers that are corporations (other than Subchapter S corporations) having the same taxable year and that are members of the same unitary business group may elect to be treated as one taxpayer for purposes of any original return, amended return which includes the same taxpayers of the unitary group which joined in the election to file the original return, extension, claim for refund, assessment, collection and payment and determination of the group's tax liability under this Act. This subsection (e) does not permit the election to be made for some, but not all, of the purposes enumerated above.

Under this provision of the statute, taxpayers that are members of a unitary business group filing on a combined basis can elect to be treated as one taxpayer for filing an amended return or a refund claim. However, an amended return filed on a combined basis can only include the members which joined in the election to file the original return. Since “TQB” originally filed a separate return, and “TQB-S” and “TQB-I” each filed separate unitary returns for the years at issue, this provision would prevent “TQB” and “TQB-I” from being treated as a single taxpayer.

However, the Department's regulations provide an exception to this rule that applies in this case. Regulation § 100.5210(a)(2), 86 Ill. Admin. Code § 100.5210(a)(2), in relevant part, provides as follows:

> If an eligible member fails to have its income and factors included in the combined return, then the tax liability of that member shall be determined on the basis of a separate unitary return unless the failure of such member was due to a mistake of law or fact, or to inadvertence (as determined by the designated agent) in which case the failure must be corrected prior to the issuance of any Notice of Deficiency. Where such failure is corrected, such member shall be treated as if it had properly consented and been included in the election from the beginning.

This regulation allows a taxpayer to file an amended combined return to include a unitary business member in its combined return if the member was excluded due to a mistake of fact or law or due to inadvertence and the amended return is filed prior to the issuance of a notice of deficiency. Under the provisions of this regulation, when the amended return correcting the exclusion error is filed, each member of the unitary group included in the combined return is treated as if it had consented and been included from the beginning. The failure to include "TQB" in combined returns for the years at issue in this case was due to a misunderstanding or lack of knowledge of the Department's application of the 80/20 rule in the case of a non-U.S. corporation doing business in the U.S. and elsewhere. This was a mistake of law.

Next, the regulation provides that if the failure is corrected the incorrectly excluded "member shall be treated as if it had properly consented and been included in the election from the beginning." *Id*. The amended returns filed by the taxpayer corrected the situation so the excluded member, "TQB" must be treated as if it had properly consented to being included from the beginning. Thus, the amended returns filed by the taxpayer in this case satisfied the requirements of Reg. § 100.5210(a)(2). Under these rules, the two corporations are treated as being one taxpayer under Section 502(e) so the consent to extend the statute of limitations executed by “TQB-I” would have extended the statute for “TQB” as well as for itself. For these reasons, taxpayer’s refund claim for the year ended October 31, 1991 should be allowed.

The Department asserts that the “TQB’s” refund claim is barred by the statute of limitations because “TQB” did not file a consent to extend the statute of limitations. The Department’s arguments are not persuasive. The Department states that if “TQB's” claim is not barred by the statute of limitations, ““TQB” could file an Il-1120-X claiming a refund fifteen or twenty years after filing an IL-1120, even if it has not executed an IL-872 extending the statute of limitations.” That statement is not correct. The consent to extend the statute of limitations executed by “TQB-I” applied as well to “TQB” because of the Department’s determination that “TQB-I” and “TQB” were members of a unitary group that should have filed a combined return, which they did when they filed their amended returns. That consent provided a date after which refund claims filed by either entity would be forever barred.

Further, the Department’s argument ignores the language in Section 502(e) that states in part that “members of the same unitary business group **may elect to be treated as one taxpayer** for purposes of any original return, amended return which includes the same taxpayers of the unitary group which joined in the election to file the original return, extension, claim for refund, assessment, collection and payment and determination of the group's tax liability under this Act. This subsection (e) does not permit the election to be made for some, but not all, of the purposes enumerated above.” The Department ignores the requirement that the members of the group be treated as one taxpayer. In addition, the

Department ignores the language that provides that the election applies to extensions and refunds as well as to assessments.

The Department also ignores the language in Reg. § 100.5210(a)(2) that requires that "Where such failure is corrected, [the previously excluded] member shall be treated as if it had properly consented and been included in the election from the beginning." Under the Department's interpretation, "TQB" would not be treated as if it had consented from the beginning as required by the regulation. The Department's position is contrary to its own regulation and would render meaningless the language in the statute requiring the unitary group members to be treated as one taxpayer and the language in the regulation providing the members of the group to be treated as if they had consented from the beginning.

The Department cites Dow Chemical Co. v. Department of Revenue, 224 Ill.App.3d 263 (1st Dist. 1991) in support of its position. The Department's reliance on the opinion in this case is misplaced. First, the facts in Dow Chemical Co. are distinguishable from the facts of this case. In Dow Chemical Co., Dow and its subsidiary corporations filed their tax returns for 1975 through 1978 on a separate company basis. As the result of an audit and re-audit, the Department determined that Dow Chemical Co. and its subsidiaries were a unitary group and completed the examination by calculating their tax liability on a unitary basis. The unitary computation resulted in overpayments for Dow and other members of the unitary group. Dow claimed a refund in an amended protest but failed to file refund claims or a waiver of the expiration of the statute of limitations before the time limit for filing claims expired. The Department denied the claims and the Court upheld the Department because Dow failed to file claims before the statute of limitations barred claims.

In the instant case, "TQB" filed its claim for refund for 1991 during the period allowed by the consent to extend the expiration of the statute of limitations executed by "TQB-I". Also, in this case no Notice of Deficiency was issued as it had been in Dow. "TQB" consented to the Department's position regarding its filing status and filed its amended returns as the Department suggested. Lastly, the regulation upon which the taxpayer is relying in this case, Reg. § 100.5210(a)(2), was not in effect for the years involved in the Dow Chemical Co. case.

Finally, because I have decided that taxpayer's claim for refund should be allowed, I need not address whether the Department's denial of "TQB's" claim for refund violates the Uniformity Clause, Article IX, Section 2, of the Illinois Constitution.

For the reasons set forth above, I recommend that the taxpayer's motion for summary judgment be granted and the Department's cross-motion for summary judgment denied. The taxpayer's claim for refund for the year ended October 31, 1991, after adjustment to take into account the Department's sales tax factor adjustment, should be granted.

ENTER: February 8, 2000

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Administrative Law Judge